3 Keeping Books and Records

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LEARNING OUTCOMES

After reading this chapter, you should be able to:

- understand the concept of a fiscal year
- understand the accounting cycle
- demonstrate an understanding of debits and credits
- complete an analysis of transactions using double-entry bookkeeping
- record transactions in a general journal

Accounting Period

Accounting records are prepared, and procedures are performed, over the course of the **accounting period**. The process that begins with analyzing and recording business transactions into journals, and ends with the completion of a post-closing trial balance, is referred to as the **accounting cycle**. The steps in the accounting cycle are described in the next section.

Accounting periods of equal length, called **fiscal periods**, are used to measure the financial progress of a business over time. Periods may be defined as monthly, quarterly, or annual. The accounting or fiscal period refers to the period of time for which an income statement is prepared. The length of each accounting period will vary depending on the type and size of business being conducted. If you wish to compare results from one period to the next, you must examine the results over consistent periods of time. It is not helpful to compare the results for six months with results for a 12-month period. When you file tax returns, the results you report to the Canada Revenue Agency will have to cover a 12-month period. When the period covers 12 months it is called the **fiscal year**. The fiscal year-end is the date upon which the financial year finishes. The fiscal year-end does not have to be December 31.

Selecting a year-end for a business depends on various concerns the owner may have, such as the following:

- Are tax benefits available if the business does not use December 31 (the calendar year) as the year-end?
- What additional records will be required if the business does not use the calendar year?
- Is the business seasonal, and does the owner prefer to have a fiscal period that corresponds to a quiet time of the year?

Once you have selected your fiscal year-end for tax purposes, the Canada Revenue Agency will not allow you to change it without its consent, as this would create inconsistencies in the financial reports. Having a year-end that does not finish on December 31 complicates the bookkeeping because many expenses—such as Law Society dues, remittances of employees' tax deductions, and Canada Pension Plan and Employment Insurance premiums—must be calculated on a calendar-year basis. T4 slips issued to employees must cover salary over the calendar year. The additional record-keeping required when selecting a year-end other than December 31 is often a deterrent.

The Accounting Cycle

The accounting cycle is the process of analyzing and recording business transactions and producing financial statements from the information. This cycle takes place over a fiscal period covered by the income statement. You may wish to complete the cycle once every month, every

quarter, or once a year. Many paralegals use a one-year accounting period but may produce interim reports each month.

The order in which the steps in the accounting cycle are completed is as follows:

1. After a business transaction occurs, journalize the transaction using a general journal, trust journal, and/or specialized journal.
2. Post the journal entry to the general ledger and/or trust ledger.
3. Prepare the trial balance.
4. Prepare the worksheet.
5. Prepare the adjusted trial balance.
6. Prepare the financial statements.
7. Record adjusting and closing entries.
8. Calculate the **post-closing trial balance**.

Figure 3.1 illustrates the steps of the accounting cycle.

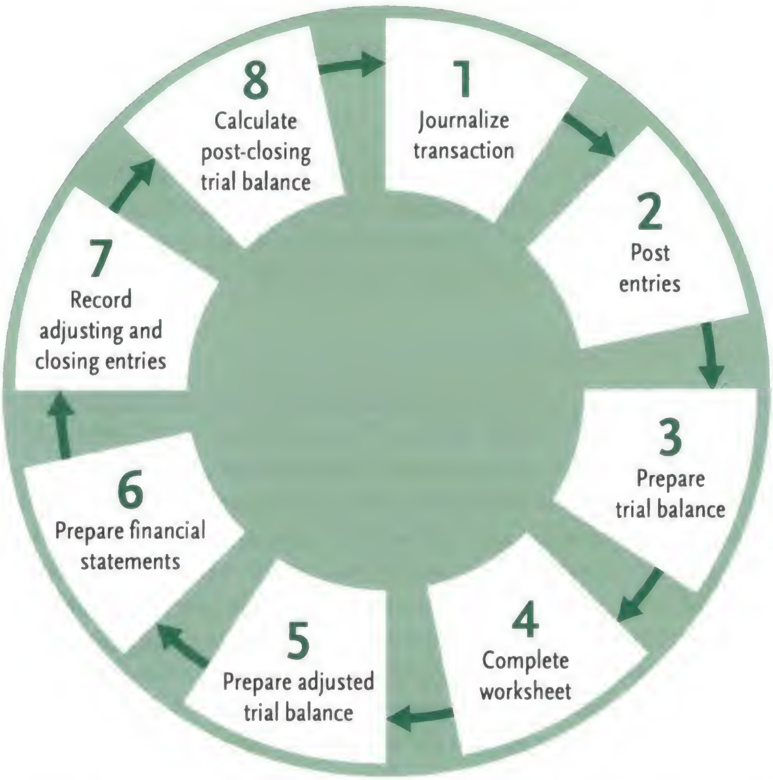

FIGURE 3.1 Steps of the accounting cycle. Note that the post-closing trial balance in step 8 is carried forward as the opening balance for the next period.

The Transaction

The process starts when the business owner enters into a financial transaction. The transaction might be for cash or for credit. As an example, the paralegal may purchase a piece of equipment, pay rent, or charge fees to a client. All financial activities involving the business are transactions. An additional consideration for paralegals is that the transaction may involve the trust account and trust records.

Journal Entries

The basic general journal usually has two columns—a debit column and a credit column. It is called the "book of original entry" because this is where transactions are first recorded in chronological order. The **journal entries** involve a double-entry system in which there is at least one debit entry and one credit entry for each transaction. The basic trust journals, which are also books of original entry, will be used to record funds received in the trust account and disbursements made from the trust account.

Posting

Once the entries have been recorded in the general journal, they are summarized using **general ledgers**. The ledger posts the journal entries by category in the order shown on the chart of accounts. The set of books will have one general ledger sheet for each of the accounts used in the business. Each general journal entry is posted to the account affected by the transaction. **Posting** also will be done from the trust journal to the individual client trust ledger sheets so that the funds held in the mixed trust account are properly accounted for.

Trial Balance

When the accounting period is at an end (month, quarter, or year), a list of the totals in all the ledger accounts is prepared. This is called a **trial balance** and it is calculated to ensure that debits are equal to credits. If they are not equal, this indicates that an error occurred in one or more journal entries. Errors must be corrected before proceeding to the next step.

Worksheet

If **adjustments** need to be made to the balances in any accounts after the trial balance is prepared, the worksheet is used to make the changes desired. The worksheet is an internal document used to track the changes made to various accounts. Adjustments can also be made at the end of a period to allocate expenses to the correct accounts. For example, the paralegal may have paid motor vehicle insurance premiums and entered the amount as an asset under the account called "prepaid insurance." However, at the end of the period, part of the premiums will have been used up, and the amount used must be moved from the assets portion of the balance sheet to the expense portion. An adjusting entry would be made reducing the amount in the asset account (prepaid insurance) and increasing the insurance expense amount in the books to show how much insurance was expended. Once the adjustments for the period are done, another trial balance is prepared to ensure that the debits and credits are still equal. This is called the adjusted trial balance.

Adjusting Journal Entries

The worksheet is an internal document that does not form part of the office records of the company. The adjustments made on the worksheet must be entered into the general journal in order to update and bring the entries from the worksheet into the official records of the firm.

Financial Statements

The **financial statements**—an income statement showing the revenue and expenses of the business, a statement of owner's equity, and a balance sheet—are prepared once the adjusting entries have been entered in the ledgers, and an adjusted trial balance has been prepared.

Closing the Books

The owner will want to start a new accounting cycle each fiscal year, so the revenue and expense accounts in the ledgers (referred to as temporary accounts) must be closed. This is called **closing the books**, the final step of the accounting cycle after adjusting and closing entries are recorded. The balance sheet accounts (permanent accounts) are not closed at the end of the cycle because the amounts in those accounts are carried forward from period to period.

Basic Rules of Debit and Credit

You will recall that in Chapter 2 we created journal entries to record the opening balance sheet of Justin Case's firm as of October 1, 20**. When making the entries in the general journal, we had at least two entries for each transaction—an entry on the left side, referred to as a **debit (Dr.)**, and an entry on the right side, called a **credit (Cr.)**. The total debits were equal to the total credits.

As a rule, the assets side of the balance sheet is the debit side (left side). The liabilities and owner's equity side is the credit side (right side). Do not give any other meaning to the words debit and credit.

Debits (Dr.)	=	Credits (Cr.)
Left Side	=	Right Side

This double-entry method of accounting requires that two entries be made for each transaction: a debit entry in one account is always offset by an equal credit entry in another account. In order for the books to be balanced, the total debits entered must equal the total credits.

Debits and Credits

Points to keep in mind about the terms *debit* and *credit*:

- Assets are shown on the left side of the accounting equation and normally have a debit balance (**normal debit balance**).
- Liabilities and owner's equity are shown on the right side of the accounting equation and normally have a credit balance (**normal credit balance**).
- Every transaction you record will have at least one debit and one credit. The total amount of the debits and credits must be equal when you are finished creating the entry.
- You may have a transaction, called a **compound entry**, that affects three or more accounts. At the end of the entry, the total debits must still equal the total credits.
- A debit entry might increase the balance in some accounts (for example, asset accounts), and a debit entry might decrease the balance in other accounts (for example, liability accounts).
- The account balance is the difference between the debit entries and credit entries, which either increases or decreases the value of an account.
- A credit entry can increase the balance in some accounts (for example, liabilities), and a credit entry can decrease the balance in some accounts (for example, assets).

Loan Payable (Liability Account)

Dr.	Cr.
Entry on this side *decreases* balance	Entry on this side *increases* balance

General Bank Account (Asset Account)

Dr.	Cr.
Entry on this side *increases* balance	Entry on this side *decreases* balance

- Although your personal bank statement may show deposits as a credit, a credit in your cash or general bank account in your books does not result in an increase in your bank balance; it actually represents a *decrease* in your bank account balance. When you receive a statement from your bank, the bank shows a deposit you make as a credit because the deposit is actually a liability for the bank—the bank owes you the money you have deposited in the bank account. Bank statements are done from the perspective of the bank and what it owes to its customers.
- Making an entry on the debit side (left side) or credit side (right side) is simply a system used to increase or decrease the balance in an account—nothing more.
- All asset accounts, such as cash, equipment, or office furniture, normally have a debit balance. Therefore, to increase the balance in an asset account, you need to debit the account. For example, if $1,000 in cash is deposited into the bank account, you will show the deposit in your books as a "general bank account" debit.

General Bank Account

Dr.	Cr.
Increase	Decrease
1,000	

- If a cheque for $50 is written against your bank account, you need to credit the general bank account by that amount because you are decreasing the balance in the asset (general bank account) by $50 (credit), leaving a balance of $950.

General Bank Account

Dr.	Cr.
Increase	Decrease
1,000	
	50
Bal. 950	

- Liability accounts (such as loans payable or credit card debt) are shown on the right side of the accounting equation and have a normal credit balance. To increase the balance in a liability account, the account is credited. For example, if a charge of $120 is made to the credit card, you will credit the credit card debt account because the debt is increasing.

Credit Card Debt

Dr.	Cr.
Decrease	Increase
	120

- If a payment is made on the credit card debt, you are decreasing the amount of the debt, which is a liability, and you will make the entry on the debit side. If $100 was paid on the credit card you would show it as a debit, leaving a balance of $20 owing on the credit card.

Credit Card Debt

Dr.	Cr.
Decrease	Increase
	120
100	
	Bal. 20

- Owner's equity is on the right side of the accounting equation. The capital account, which shows the investment made by the owner in the business, has a normal credit balance. If the owner invests $1,000 into the business, the capital account must be credited to show an increase in the balance.

Justin Case, Capital

Dr.	Cr.
Decrease	Increase
	1,000

- When a business owner takes $800 out of the business for personal use, it is called a withdrawal. The drawings account (which has a normal debit balance) is debited when a withdrawal is made because the owner's capital (which has a normal credit balance) is being decreased.

Justin Case, Withdrawal

Dr.	Cr.
Increase	Decrease
800	

- Revenues are entered as a credit because when income is earned, this ultimately results in an increase in the owner's capital (which has a normal credit balance). Fees earned of $2,000 would be shown on the credit side in the fees earned account (which has a normal credit balance).

Fees Earned

Dr.	Cr.
Decrease	Increase
	2,000

- Expenses are entered as a debit because they ultimately reduce the owner's capital. For example, telephone expense of $180 would be recorded as a debit.

Telephone Expense

Dr.	Cr.
Increase	Decrease
180	

Proving the Business Transaction

When a business transaction occurs, evidence of that transaction must be retained. This may be a bill sent online or in the mail, or a receipt or voucher from a purchase made at a store.

TAX TIP

Receipts

When accounting to the Canada Revenue Agency, you must keep all receipts to prove the nature of your business transactions. A charge as shown on a credit card or bank statement, or even a cancelled cheque, is not considered a valid receipt for tax purposes. The original voucher from a vendor must be available for the purpose of auditing. The reason is that although the charge shown on your bank statement or credit card indicates that something was purchased at an office supply store, it does not specify what was bought—were the purchases really office supplies for the business, or school supplies for the owner's children? The original receipt from the store explains what the expense was for, not just the fact that money was spent at a particular place of business.

The receipt obtained must be kept and entered into the firm's books. A system for filing receipts must be established. Some people like to file bills by order of date; others prefer to have separate file folders with the names from the chart of accounts so that the receipts for a particular account are kept in one folder. This enables you to look at the file and see all the bills charged to that account. For example, you may wish to have a file folder named Telephone Expense and place all bills related to telephone expenses for the office in that file. If a question arises, you need to look through only one folder rather than through the bills for all the items the firm may have purchased over a particular period of time.

If a bill shows a charge for GST or HST, the registration number of the business must be included on the bill. If the registration number is not shown, the tax department may refuse to allow a credit for the tax paid.

Analyzing the Transaction

Business transactions must be recorded in the firm's books. As previously mentioned, the general journal is the "book of original entry." When you make a general journal entry, you must analyze the transaction to determine which accounts in your firm's chart of accounts are affected. The following questions will help your analysis:

- Which accounts are affected by the transaction? Look at the chart of accounts and identify which accounts will be used to record the transaction.
- Determine the category of account that is affected. Is it an asset, liability, capital, income, or expense account?
- Does the balance in the account increase or decrease because of the transaction?
- Which account will be debited and which account will be credited?
- Is the entry balanced—are your debts and credits equal after you have finished making the entry?

The biggest challenge for people learning double-entry bookkeeping is knowing which account to use and when to debit or credit an account. One simple memory device to help you distinguish debits from credits is the acronym **DEAD CLIC** (Figure 3.2).

Side of the account used to record an increase

	Debit	**C**redit	
Accounts with a normal debit balance + = Dr.	**E**xpenses	**L**iabilities	Accounts with a normal credit balance + = Cr.
	Assets	**I**ncome	
	Drawings	**C**apital	
	DEAD	**CLIC**	

FIGURE 3.2 The acronym DEAD CLIC will help you distinguish debits from credits.

DEAD stands for the categories of accounts that have a normal debit balance, that is, you debit expenses, assets, and drawings to increase their balance. If you want to decrease the balance in any of these accounts, you will need to credit the account.

CLIC stands for the categories of accounts that have a normal credit balance, that is, liabilities, income, and capital. If you want to increase the balance in any of these accounts, you must credit the account. If you want to decrease the balance, you will need to debit the account.

Your first step in using DEAD CLIC is to learn to recognize the category of account with which you are dealing.

In a double-entry bookkeeping system, two or more accounts will be affected by any transaction. Remember that the total debits and credits must be equal after each entry is made in the general journal.

In order to analyze a transaction, ask yourself the following questions:

- What did the firm give and what did the firm receive in this transaction?
- Which account is used for the item received and which account is used for the item given?
- What is the normal balance of the account—debit (DEAD) or credit (CLIC)?
- Will the account increase or decrease because of the transaction?
- Will the account be debited or credited? By what amount?
- Is the entry balanced?

Other Types of Entries

Sometimes you may run into an entry that involves more than two accounts or a shift in assets.

Compound Entries

A compound entry requires more than one debit or more than one credit. For example, if office furniture is purchased for $2,000, and $500 is paid by cheque and $1,500 is purchased on credit, you will have three entries.

	Debit	*Credit*
Office Furniture	2,000	
General Bank Account		500
Accounts Payable/General Liabilities		1,500
To record purchase of office furniture		

FIGURE 3.3 Recording a compound entry

Shift in Assets

A shift in assets occurs when two asset accounts are affected by a transaction. For example, suppose computer equipment is purchased that costs $1,000 and it is paid for with cash (a cheque drawn on the general bank account). You will have an increase in the computer equipment account and your general bank account will decrease. The total value of your assets has not changed; however, the value of the computer equipment account has increased and the value of the general bank account has decreased, reflecting a shift in assets. This entry would be shown by debiting the computer equipment account and crediting the general bank account.

	Debit	Credit
Computer Equipment	1,000	
General Bank Account		1,000
To record purchase of computer equipment		

FIGURE 3.4 Recording a shift in assets

Examples of Transactions

The following examples illustrate the application of debits and credits in double-entry bookkeeping and recording transactions in a general journal.

EXAMPLE 1

On October 5, Justin Case wrote a cheque for $300 to Bell Canada to pay the telephone bill for his office.

Analysis of Transaction		Result
Step 1:	What did the firm give and what did the firm receive in this transaction?	• The firm received a phone bill. • The firm gave money (a cheque) as payment.
Step 2:	Which account is used for the item received and which account is used for the item given?	• Telephone Expense is used to record telephone bills received. • General Bank Account is used to record payment.
Step 3:	What category of account is it?	• Telephone Expense is an expense account. • General Bank Account is an asset account.
Step 4:	Will the account increase or decrease because of the transaction?	• Telephone Expense will increase. • General Bank Account will decrease.
Step 5:	Will the account be debited (DEAD) or credited (CLIC)? By what amount?	• Telephone Expense will be debited for $300. • General Bank Account will be credited for $300.
Step 6:	Is the entry balanced?	• Yes, there is a debit of $300 and a credit of $300.

General Journal					GJ2
*Date 20***		*Description*	*PR*	*Debit*	*Credit*
Oct.	5	Telephone Expense		300	
		General Bank Account (Cash)			300
		Paid telephone expense for Oct.			

EXAMPLE 2

Compound entry: On October 5, Justin Case purchased office furniture from IKEA for $2,000. He paid $500 by cheque and $1,500 was put on his credit card. This compound entry will involve three different accounts.

Analysis of Transaction	Result
Step 1: What did the firm give and what did the firm receive in this transaction?	• The firm received office furniture. • The firm gave money (a cheque) as partial payment. • The firm also gave the credit card as partial payment.
Step 2: Which account is used for the item received and which account is used for the item given?	• Office Furniture and Equipment Fixtures is the account used for furniture received. • General Bank Account is used to record payment for the furniture. • Credit Card Debt is used to record the liability incurred on the card.
Step 3: What category of account is it?	• Office Furniture and Equipment is an asset account. • General Bank Account is an asset account. • Credit Card Debt is a liability account.
Step 4: Will the account increase or decrease because of the transaction?	• Office Furniture and Equipment will increase. • General Bank Account will decrease. • Credit Card Debt will increase.
Step 5: Will the account be debited (DEAD) or credited (CLIC)? By what amount?	• Office Furniture and Equipment will be debited $2,000. • General Bank Account will be credited $500. • Credit Card Debt will be credited $1,500.
Step 6: Is the entry balanced?	• Yes, there is a debit of $2,000 and a credit of $500 plus $1,500.

General Journal **GJ2**

*Date 20***		*Description*	*PR*	*Debit*	*Credit*
Oct.	5	Telephone Expense		300	
		General Bank Account (Cash)			300
		Paid telephone expense for Oct.			
	5	Office Furniture and Equipment		2,000	
		General Bank Account (Cash)			500
		Credit Card Debt			1,500
		To record furniture purchased from IKEA			

EXAMPLE 3

On October 8, Justin Case received $500 by way of a scholarship for having obtained the highest marks in his class. Justin wishes to invest this amount in his firm.

Analysis of Transaction	**Result**
Step 1: What did the firm receive and what did the firm give in this transaction?	• The firm received money from Justin. • The firm gave equity in the firm to Justin.
Step 2: Which account is used for the item received and which account is used for the item given?	• General Bank Account is used to record cash received. • Justin Case, Capital is used to record an increase in investment by the owner.
Step 3: What category of account is it?	• General Bank Account is an asset. • Justin Case, Capital is an owner's equity account.
Step 4: Will the account increase or decrease because of the transaction?	• General Bank Account will increase. • Justin Case, Capital will increase.
Step 5: Will the account be debited (DEAD) or credited (CLIC)? By what amount?	• General Bank Account will be debited for $500. • Justin Case, Capital will be credited for $500.
Step 6: Is the entry balanced?	• Yes, there is a debit of $500 and a credit of $500.

General Journal **GJ2**

*Date 20***		*Description*	*PR*	*Debit*	*Credit*
- -[1]					
Oct.	5	Office Furniture and Equipment		2,000	
		General Bank Account (Cash)			500
		Credit Card Debt			1,500
		To record furniture purchased from IKEA			
	8	General Bank Account		500	
		Justin Case, Capital			500
		To record investment of scholarship			

1 The broken lines here and in the tables that follow indicate that the page has been split, so that the whole general journal need not be shown each time.

EXAMPLE 4

On October 10, Justin opened an account with a legal stationer, Legal Supplies Inc., and purchased office supplies from them worth $580. Terms for payment on account are net 30 days, after which interest will be charged.

Analysis of Transaction		Result
Step 1:	What did the firm give and what did the firm receive in this transaction?	• The firm received office supplies. • The firm gave a promise to pay within 30 days.
Step 2:	Which account is used for the item received and which account is used for the item given?	• Office Supplies/General Expense is used because the supplies will be used up within the year. • Accounts Payable/General Liabilities is used to record the promise to pay Legal Supplies Inc. for the purchase on credit.
Step 3:	What category of account is it?	• Office Supplies/General Expense is an expense account. • Accounts Payable/General Liabilities is a liability account.
Step 4:	Will the account increase or decrease because of the transaction?	• Office Supplies/General Expense will increase. • Accounts Payable/General Liabilities will increase.
Step 5:	Will the account be debited (DEAD) or credited (CLIC)? By what amount?	• Office Supplies/General Expense will be debited by $580. • Accounts Payable/General Liabilities will be credited by $580.
Step 6:	Is the entry balanced?	• Yes, there is a debit of $580 and a credit of $580.

General Journal GJ2

*Date 20***		*Description*	*PR*	*Debit*	*Credit*
- - -		- -			
Oct.	8	General Bank Account		500	
		Justin Case, Capital			500
		To record investment of scholarship			
	10	Office Supplies/General Expense		580	
		Accounts Payable/General Liabilities			580
		To record purchase from Legal Supplies Inc.			

EXAMPLE 5

Shift in assets: On October 15, Justin purchased a second-hand filing cabinet at Office Equipment Inc., a used office equipment store. He paid $100 by cheque.

Analysis of Transaction	Result
Step 1: What did the firm give and what did the firm receive in this transaction?	• The firm received a filing cabinet. • The firm gave cash (a cheque) to pay for the cabinet.
Step 2: Which account is used for the item received and which account is used for the item given?	• Office Furniture and Equipment is used for the item received. • General Bank Account is used for the item given.
Step 3: What category of account is it?	• Office Furniture and Equipment is an asset account. • General Bank Account is also an asset account.
Step 4: Will the account increase or decrease because of the transaction?	• Office Furniture and Equipment will increase. • General Bank Account will decrease.
Step 5: Will the account be debited (DEAD) or credited (CLIC)? By what amount?	• Office Furniture and Equipment will be debited $100. • General Bank Account will be credited for $100.
Step 6: Is the entry balanced?	• Yes, there is a debit of $100 and a credit of $100.

General Journal **GJ2**

*Date 20***		*Description*	*PR*	*Debit*	*Credit*
- - -	- - -	- - - - - - - - - - - -	- - -	- - -	- - -
Oct.	10	Office Supplies/General Expense		580	
		Accounts Payable/General Liabilities			580
		To record purchase from Legal Supplies Inc.			
	15	Office Furniture and Equipment		100	
		General Bank Account			100
		Purchased filing cabinet from Office Equipment Inc.			

EXAMPLE 6

Payment for services rendered: On October 20, Justin gave a bill to his first client, Judith Sabourin, in the amount of $3,000 and she paid him with a cheque.

Analysis of Transaction		Result
Step 1:	What did the firm give and what did the firm receive in this transaction?	• The firm provided services to a client. • The firm received a cheque payment for the services rendered.
Step 2:	Which account is used for the item received and which account is used for the item given?	• General Bank Account is used to record the payment received. • Fees Earned is used to record the bill given to the client for the services rendered.
Step 3:	What category of account is it?	• General Bank Account is an asset account. • Fees Earned is an income account.
Step 4:	Will the account increase or decrease because of the transaction?	• General Bank Account will increase. • Fees Earned will increase.
Step 5:	Will the account be debited (DEAD) or credited (CLIC)? By what amount?	• General Bank Account will be debited for $3,000. • Fees Earned will be credited for $3,000.
Step 6:	Is the entry balanced?	• Yes, there is a debit of $3,000 and a credit of $3,000.

General Journal **GJ2**

*Date 20***		*Description*	*PR*	*Debit*	*Credit*
- - -		- - -			
Oct.	15	Office Furniture and Equipment		100	
		General Bank Account			100
		Purchased filing cabinet from Office Equipment Inc.			
	20	General Bank Account		3,000	
		Fees Earned			3,000
		To record fees billed to Sabourin and paid			

EXAMPLE 7

Expenses: On October 30, Justin Case paid rent of $500 for one month. Use the same process to record this expense as was used in example 1 to record an expense.

Analysis of Transaction		**Result**
Step 1:	What did the firm give and what did the firm receive in this transaction?	• The firm paid money (a cheque) in exchange for one month's rent (for the use of the office).
Step 2:	Which account is used for the item received and which account is used for the item given?	• Rent Expense is used to record rent charged. • General Bank Account is used to record payment given.
Step 3:	What category of account is it?	• Rent Expense is an expense account. • General Bank Account is an asset account.
Step 4:	Will the account increase or decrease because of the transaction?	• Rent Expense will increase. • General Bank Account will decrease.
Step 5:	Will the account be debited (DEAD) or credited (CLIC)? By what amount?	• Rent Expense will be debited for $500. • General Bank Account will be credited for $500.
Step 6:	Is the entry balanced?	• Yes, there is a debit of $500 and a credit of $500.

General Journal GJ2

*Date 20***		*Description*	*PR*	*Debit*	*Credit*
Oct.	20	General Bank Account		3,000	
		Fees Earned			3,000
		To record fees billed to Sabourin and paid			
	30	Rent Expense		500	
		General Bank Account			500
		To record rent paid for one month			

Figure 3.5 shows the general journal after all October transactions (examples 1 through 7) have been entered and totalled.

General Journal					GJ2
*Date 20***		*Description*	*PR*	*Debit*	*Credit*
Oct.	5	Telephone Expense		300	
		General Bank Account (Cash)			300
		Paid telephone expense for Oct.			
	5	Office Furniture and Equipment		2,000	
		General Bank Account (Cash)			500
		Credit Card Debt			1,500
		To record furniture purchased from IKEA			
	8	General Bank Account		500	
		Justin Case, Capital			500
		To record investment of scholarship			
	10	Office Supplies/General Expense		580	
		Accounts Payable/General Liabilities			580
		To record purchase from Legal Supplies Inc.			
	15	Office Furniture and Equipment		100	
		General Bank Account			100
		Purchased filing cabinet from Office Equipment Inc.			
	20	General Bank Account		3,000	
		Fees Earned			3,000
		To record fees billed to Sabourin and paid			
	30	Rent Expense		500	
		General Bank Account			500
		To record rent paid for one month			
		Totals		6,980	6,980

FIGURE 3.5 General journal after all October transactions have been entered and totalled

The General Journal

As each transaction in examples 1 through 7 was analyzed, it was recorded in the general journal on page 2 (GJ2). All the information regarding each transaction is captured in this journal—the date the transaction occurred, the names of the accounts affected, the amounts debited and credited, and an explanation of what the entry was for.

There are a number of conventions regarding journal entries that you should keep in mind:

- Enter the year on the first line at the top of the first column.
- Enter the month on the first line of the journal entry. You do not need to enter the month again unless you start a new page or the month changes.
- Enter the day of the transaction in the second column on the first line of each entry. Transactions are entered in chronological order (by order of date).
- Enter the name of the account to be debited on the first line of the entry. Note that debits are always entered first. Use the name of the account as it is shown on the chart of accounts being used by the firm. The debit entry should be aligned at the margin. Enter the amount to be debited in the debit column on the same line. Dollar signs are not usually used in journals and ledgers.
- Enter the name of the account to be credited on the next line of the entry. Use the name of the account as it is shown on the chart of accounts being used by the firm. The credit entry should be indented by about three spaces (or 1 cm). This provides a visual clue that the entry is a credit entry.
- Enter the credit amount in the credit column.
- Enter a brief explanation of what the entry is for. This entry is usually indented by about four spaces (or 1.2 cm) and italicized to distinguish it from the credit entries. When providing the explanation for the transaction, you may want to indicate the name of who was paid, or what month the bill was for.
- Skip one line between each new entry.
- Total the general journal columns to ensure that your debits are equal to your credits. The line with totals should have a single line above and a double border below the totals.

Post Reference Column

The post reference (PR) column, sometimes referred to as the "folio" in the general journal, is left blank when a transaction is initially recorded. Individual account numbers will be entered into the PR column when entries are posted to the general ledger.

CHAPTER SUMMARY

The accounting cycle has been briefly described in this chapter. You have learned about the practical factors to consider in selecting a fiscal year. The concepts of debit and credit have been explained, and you should understand how to analyze transactions using the chart of accounts. You should be starting to understand the theory about the accounting equation and the rules of debit and credit.

Analyzing business transactions and entering them into a journal are only the first two steps in the accounting cycle, but getting them right at this stage will make completion of the other steps in the cycle much easier. The accuracy of entries in the general journal and other journals is the key to smooth sailing for completion of the other steps.

KEY TERMS

accounting cycle, 38
accounting period, 38
adjustments, 40
closing the books, 41
compound entry, 41
credit (Cr.), 41
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normal credit balance, 41
normal debit balance, 41
post-closing trial balance, 39
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trial balance, 40

FURTHER READING

Canadian Tax & Your Business (New York: About.com, 2015), online: <http://sbinfocanada.about.com/od/taxinfo/u/Canadian-Tax-And-Your-Business.htm>.

Law Society of Upper Canada, *The Bookkeeping Guide for Paralegals* (Toronto: LSUC, February 2014), online: <http://www.lsuc.on.ca/uploadedFiles/PDC/Practice_Review/Paralegal%20Bookkeeping%20Guide%20-%20February%202014.pdf>.

PUT IT INTO PRACTICE

Case Example: Analysis of Transactions

Ann Litigate is updating her bookkeeping records in preparation for the monthly meeting with her accountant. She has the following transactions to enter in the general journal but she is not sure how to analyze the transactions in order to complete the entries. Use the chart of accounts on the inside front cover of this textbook and provide your analysis of the transactions listed below:

1. Ann invoiced her client on January 1 ($3,000), but the account is now more than 40 days past due. What is the entry? What options are available to Ann?
2. Ann earned $1,200 for legal services rendered on another client file. She received a partial payment ($700) by cheque, but there is an outstanding balance of $500. What is the entry?

REVIEW QUESTIONS

True or False

_____ 1. Debit entries always cause an increase in an account.

_____ 2. Adjustments made on a worksheet should be transferred directly to the appropriate financial statement.

_____ 3. Credit entries are found on the right side of the accounting equation or T-account.

_____ 4. The accounting period is established by the tax regulator (e.g., the Canada Revenue Agency).

_____ 5. Accounting periods or fiscal periods may be calculated monthly, quarterly, or annually.

_____ 6. The normal balance for expense accounts is a debit entry.

_____ 7. The normal balance for asset accounts is a credit entry.

_____ 8. Selling office furniture or equipment will result in a credit on the right side of the balance sheet.

_____ 9. A trial balance is balanced when all the debits equal all the credits.

_____ 10. General ledger entries are ordered chronologically.

_____ 11. Each transaction must have a minimum of one debit record entry and one credit record entry.

_____ 12. A review of the journal entries and general ledger for mathematical or recording errors will help correct trial balance errors.

Short Answer

1. What are the pros and the cons of electing a December 31 fiscal year-end?
2. Briefly describe the information that the following financial statements can provide to a business owner and interested third parties or stakeholders:
   a. balance sheet
   b. income statement
   c. statement of owner's equity
3. What does it mean to close the books?

PRACTICE EXERCISES

Practice Exercise 3.1

Using the examples in the box below as a guide, show the increase and decrease that occurs for each of the transactions in the following T-accounts. Identify and insert the name of the account affected in each transaction and place the amount on the debit or credit side depending on whether the account is increasing or decreasing.

Example of T-account form:

Accounting Equation: Assets (left) = Liabilities + Owner's Equity (right)

Example, balance sheet:

Assets (100)	
Debit	Credit
(+) Increase	(–) Decrease

Liabilities (200)	
Debit	Credit
(–) Decrease	(+) Increase

Owner's Equity (300)	
Debit	Credit
(–) Decrease	(+) Increase

Owner, Drawings (350)	
Debit	Credit
(+) Increase	(–) Decrease

Example, income statement:

Income (400)	
Debit	Credit
(–) Decrease	(+) Increase

Expenses (500)	
Debit	Credit
(+) Increase	(–) Decrease

Transactions

a. A paralegal invests capital ($10,000) in a legal services firm.

Dr.	Cr.

Dr.	Cr.

b. A paralegal receives a cheque as payment from a client ($5,000) on an outstanding account for legal services.

Dr.	Cr.

Dr.	Cr.

c. A paralegal pays an invoice for professional liability insurance with cash ($1,100).

Dr.	Cr.

Dr.	Cr.

Practice Exercise 3.2

Using the examples in the box below as a guide, analyze each transaction that follows and record the appropriate entries in general journal format.

Example: On October 1, Judy Roth wrote a cheque for $300 to Minitel in payment of the phone bill.

Which two accounts are affected?	
General Bank Account	Telephone Expense

To what category do the affected accounts belong?	
Assets	Expenses

Is the affected account increasing or decreasing?	
Decreasing	Increasing

Will the account be debited or credited?	
Credit	Debit

What amount will be debited or credited to each account?	
300	300

Record the journal entry for this transaction:

*Date 20***		*Description*	*Dr.*	*Cr.*
Oct.	1	Telephone Expense	300	
		General Bank Account		300
		Payment of September telephone bill		

Transactions

a. On October 1, Judy Roth invested $2,000 in her firm.

b. On October 1, Judy Roth purchased computer equipment on account (i.e., on credit) for $800.

c. On October 5, Judy Roth invoiced a client for professional fees of $2,500.

d. On October 10, Judy Roth received partial payment of $1,500 from a client for the invoice sent in transaction (c), above.

e. On October 15, Judy Roth paid $600 cash for office furniture.

Use general journal format to illustrate the transactions in Practice Exercises 3.3 through 3.8.

Practice Exercise 3.3

Paying Office Expenses

a. May 1: Ann Litigate wrote a general cheque #25 for $200 to pay her telephone bill.

b. May 1: Ann Litigate wrote a general cheque #26 for $25 to pay Staples for office supplies expense.

Practice Exercise 3.4

Compound Entries

a. May 1: Ann Litigate purchased a computer for $1,000 from Computers R Us. She paid for the computer using a credit card and a general cheque. The cheque (#27) was written for $300 and she put $700 on the credit card.

b. May 1: Ann Litigate paid three months' rent with a general cheque #28 in the amount of $3,000 ($1,000 per month). Of that amount, $1,000 was rent expense for the current month and $2,000 was prepaid rent for the next two months' rent.

Practice Exercise 3.5

Recording and Paying Accounts Payable

a. May 15: Ann Litigate purchased a photocopier on account (on credit) from Sharpie Copiers. The cost of the copier is $5,000 and payments are to be made at the rate of $300 per month until the amount is paid in full. Her first payment is due on June 15.

b. June 15: Ann Litigate made a payment to Sharpie Copiers against the amount owed to them for the copier in the amount of $300 (cheque #29).

Practice Exercise 3.6

Recording a Shift in Assets

a. May 15: Ann Litigate purchased a fax machine from FaxMe and paid $150 with a general cheque #30.

Practice Exercise 3.7

Recording Invoices Sent to a Client and Recording Payment on Account by a Client

a. May 1: Ann Litigate prepared invoice #10 for fees earned and mailed it to her client Barbara Short for $1,500.

b. May 30: Barbara Short sent a cheque for $1,000 to the firm in partial payment of invoice #10.

Practice Exercise 3.8

Recording Investment by Owner and Withdrawal by Owner

a. May 1: Ann Litigate deposited $10,000 of her personal funds as an investment in her firm.

b. May 15: Ann Litigate withdrew $800 from the firm for her own personal living expenses (cheque #31).

Practice Exercise 3.9

Ann Litigate opened her paralegal service practice, Ann Litigate Paralegal Services, in January 20**. For each of the following transactions, analyze the transaction and prepare the appropriate general journal entry.

January 1–31, 20**:

1 Initial capital investment, $10,000

1 Professional liability insurance expense paid in full for the next 12 months with cash, $1,100

1 Law Society membership dues paid for one month with cash, $125

2 Paid monthly business insurance with cash, $50

3 Purchased office furniture with cash, $500

4 Paid for computer software by credit card, $250

5 Paid for cellphone bill by credit card, $75

5 Paid for telephone and Internet service by credit card, $145

10 Paid for court filing fees by credit card (for client, R. Scott), $200

15 Invoiced client (L. Bailey, invoice #101) for initial consultation, $175

15 Paid biweekly salary for secretary with cash, $1,000

18 Paid installment payment for leased photocopier (equipment) with cash, $240

23 Invoiced client (R. Smythe, invoice #102) for provincial offences file, $300

25 Paid process server for service of court documents and court filing by credit card for client (R. Scott), $108

26 Purchased legal accounting publication, Law Practice, Billing & Accounting, by credit card, $100

27 Retained bookkeeper based on a one-year contract and paid in advance with cash, $2,000

30 Withdrew cash from the business for personal use, $800

30 Paid biweekly salary for secretary with cash, $1,000

30 Paid bank account charges with cash (direct bank payment), $35

Ann Litigate Paralegal Services **General Journal**					**GJ1**
*Date 20***		*Description*	*PR*	*Debit*	*Credit*

Practice Exercise 3.10

a. Complete the T-accounts based on the transactions in Practice Exercise 3.9 and provide the balance for each balance sheet account. *Note: Each account starts with $0 opening balance for the purpose of this exercise.*

T-Accounts (Assets)

General Bank Account (100)	
Dr. (+)	Cr. (–)
0 OPENING BALANCE	

Prepaid Insurance (125)	
Dr. (+)	Cr. (–)
0 OPENING BALANCE	

Prepaid Expense (135)	
Dr. (+)	Cr. (–)
0 OPENING BALANCE	

Accounts Receivable (120)	
Dr. (+)	Cr. (–)
0 OPENING BALANCE	

Office Furniture and Equipment (159)	
Dr. (+)	Cr. (–)
0 OPENING BALANCE	

Computer Software (160)	
Dr. (+)	Cr. (–)
0 OPENING BALANCE	

T-Accounts (Liabilities)

Credit Card Debt (210)	
Dr. (–)	Cr. (+)
	0 OPENING BALANCE

T-Accounts (Owner's Equity)

Owner, Capital (300)	
Dr. (–)	Cr. (+)
	0 OPENING BALANCE

Owner, Drawings (301)	
Dr. (+)	Cr. (–)
0 OPENING BALANCE	

b. Complete the T-accounts based on the transactions in Practice Exercise 3.9 and add up the totals for each income and expense account; then, as a final step, total all the income and expense accounts.

T-Accounts (Income)

Fees Earned (400)

Dr. (–)	Cr. (+)

T-Accounts (Expenses)

Salaries Expense (511)

Dr. (+)	Cr. (–)

Telephone (and Internet Service) Expense (565)

Dr. (+)	Cr. (–)

Membership/Professional Dues (534)

Dr. (+)	Cr. (–)

Equipment Lease (524)

Dr. (+)	Cr. (–)

General Disbursement Expense (525)

Dr. (+)	Cr. (–)

Library and Subscriptions (530)

Dr. (+)	Cr. (–)

Insurance/Other (528)

Dr. (+)	Cr. (–)

Bank Charges (507)

Dr. (+)	Cr. (–)

Total Income and Expenses

TOTAL INCOME: $ ________ TOTAL EXPENSES: $ ________